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Testimony on AB 381 Committee on Ways and Means December 15, 2011

Chairwoman Kerkman and members of the Ways and Means committee,

Thank you also for hearing Assembly Bill 381, which allows contractors to incorporate a small amount of tangible personal property (property not permanently incorporated into a building) in a lump sum contract when they sell a building.

The Department of Revenue currently recognizes the right of a building contractor [Tax Rule 11.68(7)(b)] to not break out tangible personal property from their bid documents as a separate taxable resale if it is “minor in nature” to the cost of the overall building, and it is included in a single lump sum price to an owner. However, some Department of Revenue auditors have charged sales tax and added penalties against contractors who have sent a “schedule of values” (an itemized list of what has been installed in the building to that point) on the grounds that these materials are itemized and being sold separately. This creates a very burdensome, confusing and costly situation for contractors, suppliers and owners. A list of what is included in a building and what those items are worth to an owner should not constitute an itemized sale that suddenly turns the building contractor into a retailer of those individual materials, as these itemizations are only necessary so the bank and owner can have the information they need to make the regular payment draws to the contractor.

This bill creates a sales and use tax exemption for items and services sold as part of a lump sum contract. Under the bill, a lump sum contract is a contract to perform real property construction activities and for which the contractor quotes the charge for labor, services of subcontractors, and materials as one price, including a contract for which the contractor itemizes the charges for labor, services of subcontractors, and materials as part of a schedule of values or similar document.

The sales price from the sale of and the storage, use, or other consumption of tangible personal property, items and taxable services that are sold as part of a lump sum contract, if the total sales price of all such items is less than 10 percent of the total amount of the lump sum contract. This legislation is modeled after 2005 AB 913, which had strong bipartisan support and passed the Assembly Ways and Means Committee in a 12-0 vote.

This correction will save time and money by simplifying the accounting process while increasing transaction efficiencies for contractors and building owners and clarifying the definitions of “lump sum contract” and “sales price” as they relate to construction projects so that every contractor, building owner and DOR auditor can clearly understand what the tax rules are in every situation. This legislation does not exempt any materials from being taxed, it simply clarifies where in the process it should be collected and by whom.

I have offered a substitute amendment (ASA1) which clarifies that the exemption is intended to apply only to a contractor's sale to its customer, and not to the contractor's purchases. In this way, the contractor is deemed the consumer of such taxable products and shall pay the tax imposed on such taxable products. Placing the responsibility for tax on the contractor will ensure that increased or unwarranted costs relating to contracts with exempt entities can be avoided.

Next, the amendment defines "lump sum contract" to include taxable activities that are not real property construction activities with emphasis on taxable services as part of a schedule of values or similar document – one that itemizes the charges for labor, services of subcontractors and tangible personal property.

The substitute amendment also inserts both a transitional provision for the exemption, which first applies to contracts entered into on the effective date of this act, or three months after publication.

According to the fiscal estimate, the state sales and use tax collections may decrease by up to \$380,000. This is a small change in revenue for a tax that shouldn't exist to begin with. Contractors routinely accommodate requests by banks and property owners for detail on

additions of tangible personal property. Consequently, contractors are penalized for itemizing these services on a separate form and lay themselves open to double taxation.

The net fiscal effect of this legislation on the State is minimal because as it claims no exemption for taxing tangible personal property. However, AB 381 not only defines where the taxable event occurs in the transfer of property, but it streamlines the transfer process.

Thank you for your consideration, and I welcome any questions you may have.